


MEMORANDUM

State of Alaska Department of Law

To: The Honorable Loren Leman
Lieutenant Governor

Date: August 1, 2005

File No.: 663-05-0213

From: 
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Labor and State Affairs – Juneau

Tel. No.: 465-3600

Re: Review of Initiative Application
on Taxation of Gas Reserves
(05GAST)

I. INTRODUCTION AND SUMMARY

You have asked us to review an application for an initiative petition entitled “An Act levying a tax on certain known resources of natural gas, conditionally repealing the levy of that tax, and authorizing a credit for payments of that tax against amounts due under the oil and gas properties production (severance) tax if requirements relating to the sale and delivery of the gas are met; and providing for an effective date.” We have completed our review and find that the application complies with the constitutional and statutory provisions governing the use of the initiative. Under these circumstances we recommend that you certify the application.

II. SUMMARY OF THE PROPOSED BILL AND ANALYSIS

A. SUMMARY

This initiative would create a new state tax on certain “known gas resources,” i.e., natural gas that has been discovered but not yet developed. Sec. 2, AS 43.58.210. The tax would be two cents per year for each 1,000 cubic feet of gas. *Id.* The tax would be repealed if and when a gas pipeline system with a capacity of at least two billion cubic feet per day (“bcfd”) begins operation in the state. Sec. 4. At that point, a taxpayer could also begin to apply some taxes previously paid on known gas resources as a credit against state gas production taxes. Sec. 3, AS 43.55.027.¹

¹ Staff from the Oil, Gas and Mining section of our office provided assistance in preparing this summary of the bill to be enacted, and in the later analysis section concerning the form of the bill, as oil and gas taxation is a specialized area of law, handled by that section. We also received assistance from Dan Dickinson, Director of the Tax Division of the Department of Revenue.

This initiative appears to be modeled after a bill from the past legislative session, HB 223, that was sponsored by Representatives Eric Croft and Harry Crawford. The initiative committee representing the sponsors of the initiative is comprised of Representatives Eric Croft, Harry Crawford, and David Guttenberg. Representative Croft issued a sponsor statement on HB 223, and the two sponsors, Representatives Croft and Crawford, jointly issued two explanatory statements concerning HB 223. These materials refer to HB 223 as "the Gasline Now Act," and contain statements that describe the purpose of this bill. For instance, Representative Croft's Sponsor Statement provides that HB 223 is "a useful tool for guaranteeing construction of a gas pipeline from the North Slope, encouraging exploration for natural gas, and for filling the state's structural budget deficit until that pipeline gets built." Similarly, the statement issued jointly by Representatives Croft and Crawford provides that "[t]he Gasline Now Act is a useful tool for encouraging construction of a North Slope gas pipeline by charging a fee to gas producers for not producing Alaska's gas and refusing to ship gas or build a gas pipeline." Given the similarity between the initiative and HB 223, the sponsor materials for HB 223 may be a resource for determining the intent of the sponsors of the initiative. Therefore, we will forward a copy of the sponsor materials to you under separate cover for inclusion in the file on this initiative application.

The initiative defines "known gas resources" and provides that only certain categories of those resources are taxable. Sec. 2, AS 43.58.220, AS 43.58.295. For example, gas in the form of a gas hydrate or coal bed methane is not taxable. Sec. 2, AS 43.58.220(b). Also, the tax would apply only to gas in a state-approved oil and gas unit and would not apply if the unit has less than 1,000,000,000,000 cubic feet of known gas resources. AS 43.58.220(c). (In practice, this means that only gas in the Prudhoe Bay Unit and the Pt. Thomson Unit is expected to be subject to tax.) The Department of Revenue is charged with determining the volume of taxable gas in each state-approved oil and gas unit as of January 1 of each year, after consultation with the Department of Natural Resources and the Alaska Oil and Gas Conservation Commission. Sec. 2, AS 43.58.230(a). The Department of Revenue would also allocate the volume of taxable gas in a unit among the various owners of oil and gas leases comprising the unit. Sec. 2, AS 43.58.230(b) and (c).

The initiative includes several provisions dealing with the submission of tax returns and the payment of tax. Sec. 2, AS 43.58.240. In general, lessees having taxable gas would be required to submit an annual return to the Department of Revenue and pay the tax in question before June 30 of each year, unless the Department provides for installments. *Id.* The initiative provides, however, that a person otherwise subject to tax may avoid liability by surrendering to the Department of Natural Resources the person's

rights under the affected lease no later than December 31, 2006. Sec. 5. (This provision of the initiative has an immediate effective date.² Sec. 8.)

Numerous provisions in the initiative dealing with “lessees” make it clear that the intent of the initiative is to make oil and gas lessees liable to pay the new tax.³ However, there may be a disconnect between this intent and the initiative’s basic provisions in AS 43.58.210 and 43.58.220 that define the “property subject to tax” as, and levy the tax on, gas in the ground. It is not at all clear that an oil and gas lessee owns the gas until it has been produced. While this question has not been addressed by the Alaska courts, in a number of other states an oil and gas lease is considered in the nature of a “profit à prendre,” which allows the lessee to extract oil and gas from the property but does not convey present ownership of the resource in the ground. If the lessees do not own the gas, presumably the owner is the lessor, which in the case of state oil and gas leases is the State of Alaska. Obviously, however, the initiative proponents did not contemplate the state’s taxing itself.

Assuming that oil and gas lessees would be liable for the tax, the initiative is not completely clear whether the tax would apply only to state oil and gas leases or to other property as well. Although the initiative defines “lease” as “an oil and gas lease issued by the state,” sec. 2, AS 43.58.295(3), the term “lease” appears only occasionally in the text of the initiative. Much more common is the term “lessee,” which is not expressly limited to state oil and gas leases. “Lessee” is defined as “the lessee of record with the state as of January 1 of the tax year.” Sec. 2, AS 43.58.295(4). The concept of being “of record with the state” could be interpreted as referring to the oil and gas lease records of the Division of Oil and Gas, which deal only with state oil and gas leases, but it could also be interpreted as referring to the general records of the state property recording offices, which would include oil and gas leases on private property. Arguably, the term “lessee” should be construed as referring only to a lessee under the type of “lease” that is defined in the initiative, which would limit the term to persons holding interests in state oil and gas leases.

² Although the bill proposes an immediate effective date for section 5 of the bill, the Alaska Constitution, art. 11, sec. 6, provides that “[a]n initiated law becomes effective ninety days after certification.” See later discussion on effective date issues, and on the requirements of AS 15.45.190.

³ Since some of the leases that would be affected by this initiative produce oil and gas, the initiative might be inconsistent with AS 43.55.017(a), which *inter alia* provides that the state may not “impose a tax upon (1) producing oil or gas leases.” To the extent of any such inconsistency, however, the initiative would probably be construed as an exception to the general limitation in AS 43.55.017(a). See *Pena v. State*, 664 P.2d 169, 175 (Alaska App. 1983) (where possible, conflicting statutes will be harmonized).

The Department of Revenue is directed under the initiative to adopt implementing regulations. Sec. 2, AS 43.58.250. Under the Department's procedural regulations to be adopted, the conduct of administrative appeals must be in accordance with adjudication provisions of the Administrative Procedure Act ("APA"). *Id.* This appears to be in conflict with AS 43.05.240 – 43.05.242 and AS 43.05.405 – 43.05.499, which provide for administrative appeal procedures different from the APA for certain Department decisions regarding "all taxes levied under AS 43, except the property tax assessed under AS 43.56." AS 43.05.405.

A lessee subject to tax on known gas resources would be allowed a gas production tax credit under the initiative only after the lessee enters into a contract to sell or ship the gas, the gas is actually being sold or shipped under that contract, and a two bcfd or larger pipeline system is transporting the gas. Sec. 3, AS 43.55.027(c). The credit could be applied against up to 50 percent of the gas production tax due during a month on gas transported in that pipeline system. Sec. 3, AS 43.55.027(d). The total credit enjoyed by a lessee could not exceed the amount of tax on known gas resources incurred between the execution of the above contract to sell or ship gas and the date that commercially marketable gas is first delivered by a two bcfd or larger pipeline system. Sec. 3, AS 43.55.027(d). Nor could any credit be taken after December 31, 2030. Sec. 3, AS 43.55.027(e).

This initiative contains a number of effective date provisions. However, the general rule is that the effective date of an initiated law is governed by the Alaska Constitution. Article XI, section 6, provides that "[a]n initiated law becomes effective ninety days after certification" of the election, provided a majority of the votes cast on the proposition favors its adoption. *See also* AS 15.45.220. Therefore, if the initiative were adopted, the proposed law would become effective no sooner than the date provided by the constitution, rather than as set out in sections 8 and 9 of the proposed bill. *See* 1993 Inf. Op. Att'y Gen., at 3 (Aug. 4; 663-93-0173). Regarding the conditional effective date set out in section 7 of the proposed bill, the same general rule on effective dates would apply to this section, and the effective date of section 4 addressed in this section would be no sooner than the date specified in the Alaska Constitution.

There is a related issue concerning section 8 of the bill to be initiated, which would provide for an immediate effective date for section 5 of the bill. Section 5 of the bill allows a lessee to surrender a lease no later than December 31, 2006. However, this provision will not be effective in time for implementation by December 31, 2006, because of the timeline set out in statute for an initiative to appear on the ballot.

The timeline for an initiative to appear on the ballot is set out in AS 15.45.190:

The lieutenant governor shall direct the director to place the ballot title and proposition on the election ballot of the first statewide general, special, or primary election that is held after

- (1) the petition has been filed;
- (2) a legislative session has convened and adjourned; and
- (3) a period of 120 days has expired since the adjournment of the legislative session.

Under this timeline, the 2006 general election is the earliest election ballot upon which this initiative could appear.⁴ The initiative would not become effective until 90 days after certification of the November 2006 general election. This date would be after December 31, 2006. Therefore, given the December 31, 2006, deadline for surrender set out in Section 5, a lessee would be unable to exercise the surrender option.

It should be mentioned that page 5, line 10, of the initiative bill contains an apparent typographical error. The citation to AS 43.48.210 should be to AS 43.58.210.

B. ANALYSIS

Under AS 15.45.070, the lieutenant governor is required to review an application for a proposed initiative and either "certify it or notify the initiative committee of the grounds for denial." The grounds for denial of an application are that (1) the proposed bill is not in the required form; (2) the application is not substantially in the required form; or (3) there is an insufficient number of qualified sponsors. AS 15.45.080.

⁴ The 2006 regular legislative session will convene from January 9 to May 9, 2006. The date 120 days after May 9, 2006, falls in September 2006. The 2006 primary election will be held on August 22, 2006, and the general election will be held on November 7, 2006. Therefore, the earliest election that this initiative proposition would be considered is the November 2006 general election. The results of a general election are usually certified no sooner than a date in January following the election. Thus, the bill would not become effective until 90 days following the January 2007 election certification date.

1. The Form of the Application

The form of an initiative application is prescribed in AS 15.45.030, which provides:

The application shall include (1) the proposed bill to be initiated, (2) a statement that the sponsors are qualified voters who signed the application with the proposed bill attached, (3) the designation of an initiative committee of three sponsors who shall represent all sponsors and subscribers in matters relating to the initiative, and (4) the signatures and addresses of not less than 100 qualified voters.

The application meets the first three requirements. With respect to the fourth requirement, the Division of Elections within your office determines whether the application contains the signatures and addresses of not less than 100 qualified voters.

2. The Form of the Proposed Bill

The form of a proposed initiative bill is prescribed by AS 15.45.040, which requires that (1) the bill be confined to one subject; (2) the subject be expressed in the title; (3) the enacting clause state, "Be it enacted by the People of the State of Alaska"; and (4) the bill not include prohibited subjects. The prohibited subjects -- dedication of revenue, appropriations, the creation of courts or the definition of their jurisdiction, rules of court, and local or special legislation -- are listed in AS 15.45.010 and in article XI, section 7 of the Alaska Constitution.⁵

The form of the bill to be enacted by this initiative satisfies the requirements of AS 15.45.040. The bill is confined to a single subject, taxation of gas resources. The subject of the bill is expressed in the title of the bill, and the bill contains the required

⁵ Constitutional amendments are also a prohibited subject. *State v. Lewis*, 559 P.2d 630, 639 (Alaska 1977); *Starr v. Hagglund*, 374 P.2d 316, 317 n.2 (Alaska 1962). Recently, the Alaska Supreme Court issued a decision in *Trust the People v. State*, 2005 WL 1297915 (May 27, 2005) that raises questions about the permissible scope of pre-election review of certain implied constitutional restrictions on the use of the initiative. Although the issue presented in *Trust the People* is not an issue with regard to the gas taxation initiative, we note that we have analyzed the Court's apparent narrowing of the scope of pre-election review in 2005 Inf. Op. Att'y Gen. (Jul.1; 663-05-0225).

enacting clause language. The bill does not appear to address a subject prohibited from initiative by the Alaska Constitution.⁶

In the pre-election review of this initiative it is appropriate to consider the issue of whether the initiative proposes "local and special legislation," a prohibited subject under the Alaska Constitution, art. XI, sec. 7.⁷ The bill proposed by the initiative does not appear to be local or special legislation under the analysis set out in *Baxley v. State*, 958 P.2d 422 (Alaska 1998).⁸ The standard for evaluating whether a measure is local or special legislation is "the test applied to nonsuspect classifications in equal protection cases." *Id.* at 430. Under this test "[t]he classification must bear a reasonable and proper relationship to the purposes of the act and the problem sought to be remedied." *Id.* at 430. The court will examine the

legislative goals and the means used to advance them to determine whether the legislation bears a "fair and substantial relationship" to legitimate purposes. If this standard is satisfied, the bill will not be invalid because of incidental local or private advantages. Legislation need not operate evenly in all parts of the state to avoid being classified as local or special.

Id. at 430.

⁶ We also note that our office has advised the lieutenant governor in the past that there is no explicit prohibition on certification of applications relating to taxation. See 1985 Inf. Op. Att'y Gen. (May 10; 663-85-401); 1992 Inf. Op. Att'y Gen. (Apr.2; 663-92-0447); 1994 Inf. Op. Att'y Gen. (Jul. 14; 663-94-0667); 1999 Inf. Op. Att'y Gen. (May 25; 663-99-0214); 1999 Inf. Op. Att'y Gen. (Jul. 6; 663-99-0260); 2001 Inf. Op. Att'y Gen. (May 2; 663-01-0156); 2003 Inf. Op. Att'y Gen. (Oct. 6; 663-03-0179).

⁷ *Trust the People*, 2005 WL 1297915, at *10 (pre-election judicial review may extend only to subject matter restrictions that arise from a provision of Alaska law that expressly addresses and restricts Alaska's constitutionally-established initiative process); *Alaska Action Center, Inc. v. Municipality of Anchorage*, 84 P.3d 989, 993 (Alaska 2004)(proscriptions of article XI, section 7 of the Alaska Constitution are subject matter restrictions that provide grounds for pre-election review); *Brooks v. Wright*, 971 P.2d 1025, 1027 (Alaska 1999) (pre-election review is limited to ascertaining whether the initiative complies with the particular constitutional and statutory provisions regulating initiatives).

⁸ The Court affirmed the local and special legislation analysis set out in *Baxley* in *Evans ex rel. Kutch v. State*, 56 P.3d 1046, 1057, n. 57 (Alaska 2002).

The bill to be initiated appears to satisfy the standard set out in *Baxley*. The *Baxley* court relied on legislative findings and the legislative record in evaluating the legislation at issue in that case. Here, because we have an initiative measure there is no accompanying legislative record. However, this initiative measure appears to be based upon HB 223, from the previous legislative session. Therefore, it is reasonable to assume that a court would consider the legislative record concerning HB 223 in its evaluation of the initiative measure. As shown from the sponsor statements in support of HB 223, the purpose of the bill to be initiated appears to fit within the description of an appropriate legislative goal under *Baxley* to encourage and provide for development of state resources for the benefit of the people.⁹ *Id.* at 431. The initiative bill appears to fit within the *Baxley* rational as its sponsors indicate that the bill addresses a matter of statewide concern. Although the bill is somewhat limited in application, the sponsors have determined that the unique nature of the gas leases in question make general legislation inappropriate. According to the sponsors the gas leases to which the initiative applies contain large gas reserves appropriate for production and transmission in a gas pipeline, and the holders of the leases have little incentive to extract the gas. The sponsors indicate that the initiative seeks to maximize the economic benefits of gas production to the people of the state by encouraging timely production from these leases. Therefore, under *Baxley* the bill appears to be fairly and substantially related to legitimate state purposes, and is therefore not special legislation. *Id.* at 431.

As you know, the lieutenant governor is obligated to assure that a proposed initiative does not violate the restrictions of article XI, section 7 of the Alaska Constitution; however, the "usual rule is to construe voter initiative broadly so as to preserve them whenever possible." See, e.g., *Pullen v. Ulmer*, 923 P.2d 54, 58 (Alaska 1996); *Yute Air Alaska, Inc. v. McAlpine*, 698 P.2d 1173, 1181 (Alaska 1985). Based on our pre-election review of this initiative with respect to article XI, section 7, of the Alaska Constitution, and the various cases interpreting use of the initiative in Alaska, set out above, we do not find that the bill to be initiated here includes a prohibited subject.

In general, addressing other potential constitutional or legal infirmities must await passage of the initiative by the voters and review by the courts. See *Trust the People*, 2005 WL 1297915, at **10-14; *Brooks v. Wright*, 971 P.2d 1025, 1027 (Alaska 1999). However, the lieutenant governor does have the highly circumscribed "power to refuse to give life to proposals or laws that are clearly unconstitutional." See *Kodiak Island Borough v. Mahoney*, 71 P.3d 896, 900 (Alaska 2003); *Alaska Action Center, Inc., v.*

⁹ The sponsor documents provided in support of HB 223 indicate that the purposes of this bill include construction of a gas pipeline from the North Slope, encouraging exploration for natural gas, filling the state's structural budget deficit until the gas pipeline is built, helping American consumers, and helping the Alaskan economy.

Municipality of Anchorage, 84 P.3d 989, 992-93 (Alaska 2004); *Trust the People*, 2005 WL 1297915, at *11, n. 50. We have therefore reviewed the initiative to determine whether there are any grounds on which it is clearly unconstitutional. The novel taxation scheme set out in the initiative may raise issues relating to the Alaska Constitution's public purpose and appraisal standards requirements for taxation, art. IX, secs. 3 and 6; limitations on delegation of legislative authority under art. II, sec. 1, of the Alaska Constitution and the separation of powers doctrine; the contract clauses of the United States Constitution, art. I, sec. 10, cl. 1, and the Alaska Constitution, art. I, sec. 15; the commerce clause of the United States Constitution, art. I, sec. 8; federal preemption regarding natural gas transportation; and the equal protection provisions of the state and federal constitutions. However, we do not find that as to any of these issues the initiative is clearly unconstitutional.

III. PROPOSED BALLOT AND PETITION SUMMARY

We have also prepared a ballot-ready petition summary and title for your consideration. We have worked with staff from the oil, gas and mining section of our office, and with staff from the department of revenue, to prepare this summary. It is our practice to provide you with a proposed title and summary to assist you in complying with AS 15.45.090(2) and AS 15.45.180. We believe that it is good practice for the petition and ballot to conform to the requirements of a title (six words) and ballot summary (100 words) under AS 15.45.180. We do this in order to reduce the chance of collateral attack due to a divergence between the ballot and petition summaries. We therefore propose the following ballot and petition title and summary for your review:

Initiative On Taxation of Gas Resources

This initiative would impose a new state tax on certain large deposits of natural gas until a major gas pipeline system is built. The tax would be two cents per year for each thousand cubic feet of taxable gas in the ground. If and when the taxable gas is produced and transported in a major gas pipeline system, some of the tax payments previously made could be used as a credit against existing state gas production taxes due on the gas.

Should this initiative become law?

This summary has a Flesch test score of 54.097, which is close to the target readability score of 60. We have tried to use simple words to convey the complicated nature of the subject matter of this initiative, and we believe that the summary meets the readability standards of AS 15.60.005.

IV. CONCLUSION

For the reasons set out above, we find that the proposed bill and application are in the proper form, and that the application complies with the constitutional and statutory provisions governing the use of the initiative. Therefore, we recommend that you certify this initiative application, and so notify the initiative committee. Preparation of the petitions may then commence in accordance with AS 15.45.090.

Please contact me if we can be of further assistance to you on this matter.

cc: Laura Glaiser, Director
Division of Elections

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